No. 212

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1898

THIRD STREET AND SUBURBAN RAILWAY COMPANY,
Appellant

vs.

MEYER LEWIS.

Appeal from the United States Circuit Court of Appeals For the Ninth Circuit

BRIEF AND ARGUMENT FOR APPELLANT

STATEMENT.

Our answer, on which (p. 13) we elected to stand, states the case with sufficient clearness, perhaps, and conciseness. The title conveyed by a sale under receiver's certificates is in question. Those who purchased from the purchasers at that sale bought on the faith of instruments that constituted on their face a first lien, but they are now called into court by Meyer Lewis, who asserts that a prior lien belonging to him has not been cut off. That the property on which Meyer Lewis claimed this lien, though originally city lots belonging to a mill company, had been conveyed to a railway com-

pany, that the railway company had made railway uses of it, that after the principal of the loan was overdue and presumably could have been foreclosed, he had continued for years to accept interest from the railway company, that the railway company, becoming insolvent, passed into the hands of a receiver, that the court had jurisdiction of the property when it issued certificates, that a railway company in the hands of the court was the owner of the property, that the certificates were issued to keep the railway in existence as a *quasi* public creature, that the certificates were placed upon all the property in the hands of the court including that now claimed by Meyer Lewis, that they were issued and sold as a first lien on all, that Meyer Lewis knew of their asserted lien and issue, but did not complain of them, that he knew of the sale under them but did not object, and that he knew of the confirmation of that sale but did not seek to set it aside, are allegations of our answer. These allegations are admitted by his demurrer sustained below. It is also by the same pleadings admitted that not only did Meyer Lewis have this knowledge of what was going on in the receivership, but that he had himself relations with the court, that he accepted payments of interest on his lien before the issue of certificates as well as suffered the court to aggravate the insolvency of the trust, then running behind its operating expenses in the court's hands, by the payment of taxes and insurance on that part of the estate which he now claims free of all liens except his own. Lastly, it is admitted that the cause in which these certificates were issued is still open and pending, so that Meyer Lewis may object to the certificates there or claim his share of the proceeds of the sale or his priority over other shares.

SPECIFICATIONS OF ERROR.

The lower courts erred in sustaining the demurrer to our answer because:

I. The lien of Meyer Lewis' mortgage was wholly cut off by the unchallenged first lien of the certificates.

II. The lien of his mortgage was subject to deductions in equity on account of the sums spent by the court to protect that part of the insolvent estate and the interest paid him, which disbursements had made the certificates all the more necessary and have enabled him to profit by the court's subsequent loan while repudiating the lien on which it was obtained.

III. The sale under the certificates was presumably for the benefit of all persons interested in the estate and Mye Lewis, since he does not seek to set aside the sale, should be relegated to that court for his share of the proceeds or show why he would not be entitled to any.

IV. Meyer Lewis cannot collaterally attack the order creating the first lien of these certificates.

ARGUMENT.

Our specifications of error may be conveniently discussed by a division of our argument into the two prayers of our answer—*first*, that the mortgage is entirely cut off by the certificates; *second*, that in any event the mortgage must be charged with some of the expenses of the court.

FIRST.

THE MORTGAGE WAS WHOLLY CUT OFF BY THE CERTIFICATES.

If these certificates are not the absolute first lien they purported to be, it must be for one or all of three reasons. (*a*)

Because Meyer Lewis had not formal notice of the issue. (*b*) Because he was not a party to the action in which they were issued. (*c*) Because he was not a railway creditor and was not liable to the railway doctrines on which receiver's certificates are issued. These objections we shall answer in turn, and this will dispose of that part of the prayer of our answer which demands that the Meyer Lewis mortgage be cut off entirely. Then we shall proceed to consider the second part of our prayer, which demands that, before absolving himself entirely of the lien of the certificates, Meyer Lewis be at least forced to credit upon his mortgage such sums as upon hearing shall have been expended or paid by the receiver to him or upon his property by insurance, interest, and taxes.

(*a*)

WAS NOTICE NECESSARY TO THE ISSUE.

If the court had any right at all to bind a lien like that of Meyer Lewis with receiver's certificates, notice, it must at this date be admitted, would not be necessary. This court has itself so decided in *Union Trust Company vs Illinois Midland Company*, 117 U. S. at page 456:

"Its power to do this does not depend on consent, nor on prior notice. *Consent is desirable, but seldom praeticable*, where the debts exceed the value of the property. Though prior notice to persons interested, by notifying them as parties, first requiring them to be made parties if they are not, is generally the better way, yet many circumstances may be judicially equivalent to prior notice. A full opportunity, as in this case, to be heard, on evidence, as to the propriety of the expenditures and of making them a first lien, is judicially equivalent."

The reason why notice is not indispensible will be clear from a striking parallel which occurs to us between the power

of a court to issue these certificates and the power of a government to levy taxation. Each power is an inherent attribute of sovereignty. Each is based on the theory of protection returned. Each is based on the theory of common benefit, that is to say, as in taxation the test of the levy is public purpose, so in receiver's certificates the test is the common necessity, which, if it be shown to have existed, always relates back and cures every irregularity. Now, the power of taxation may be exercised without notice. There are certain fundamental grounds upon which taxation, even if the constitution be silent, may be resisted, but want of notice is not one of them. As a matter of fact, notice is generally provided for in legislation of this kind, but, except when constitutions require it, is not an indispensible part of a tax law. If it were, the powers of a government would be most seriously hampered in that power which alone preserves it in the emergencies of nations. It is so with certificates issued by a court to preserve property of this kind in its hands. Notice may be convenient, is generally resorted to, but is not indispensible. Indeed, it would at times be so obviously inconvenient, that, to have to resort to it, would be to defeat the very purpose for which the power is exercised. A long line of railway, traversing perhaps many states, or ramifying through many subdivisions of them, and possessing estates of very many kinds, will involve so many interests, such an innumerable variety of rights and liens, that, if the court were compelled to give notice and hearing to them all in order to create that fund which is intended to preserve them all and to sustain the obligations of the court itself, the right could scarcely ever be exercised successfully and seldom with expedition. But expedition is sometimes the essence of the thing. Suppose the power house and cars of a street railway

system are destroyed of a sudden by fire. Must the road stand idle, the franchise be lost to the owners or lienors, the public inconceivably annoyed, unless all interested parties be duly notified, some of them not yet in court and subject to speedy notice? Certainly not. It is the inherent right of the court to preserve the properties by a summary loan. So far as this case is concerned, an ample opportunity to be heard seems to have been afforded one who assumed relations with the court, accepted interest from it, knew of its proceedings, and who, after appearing in the cause, did not even take the trouble to notify others of that appearance.

We shall again have occasion to refer to this parallel between receiver's certificates and a government tax, under that part of our brief which argues that the Meyer Lewis mortgage must suffer some deductions for the interest paid him, and the insurance and taxes paid for him. The expenses of the court, even without an express levy through certificates, are judicial taxation.

(*b*)

MEYER LEWIS NOT A PARTY TO THE CAUSE IN WHICH CERTIFICATES WERE ISSUED.

Possibly it may be argued that a person must at least be a party to the cause in which certificates are issued, and that it is then that notice may be dispensed with. Has it been held accordingly that certificates will bind those who were not even parties to the cause? We think it has. In the case already cited of *Union Trust Company vs. Illinois Midland Company* we notice that on page 454 certificates were issued before certain persons were made parties.

"When the order of October 9th, 1876, was made, under which the six certificates of the 8th series were issued, neither

the trustees nor any of the bondholders of the Paris and Decatur Company were parties to the suit."

These certificates the court upheld, on page 458, saying:

"In allowing the certificates of the 8th and 14th series for necessary repairs with priority, the master (in chancery) acted, and we think properly, on the authority of *Wallace vs. Loomis* and *Miltenberger vs. Logansport R'y Co.*"

It seems quite clear that if, as is indisputable, notice is not necessary to bind those who are already parties, it ought to be no more necessary to bind those who are not yet parties. It is enough if the property is in the hands of the court to be conserved. It is enough, to recur to our pararallel of government taxation, that the estate of the non-resident be within the jurisdiction. He gets his protection and he must pay his taxes. If that tax be improper, excessive, or irregular, there is an appropriate way to correct it, and that way, as we shall subsequently show, is by petition to the court that levies the tax. If it once be conceded that notice is not necessary to those already parties, it will necessarily follow that it is not necessary to those who in fact are not parties. Certainly one may be as much injured by the lack of notice in the one case as in the other, and if the theory upon which notice can be dispensed with in the former case be correct, it will apply as well to the latter. Must the court wait until it gets into the action all the countless creditors of a railway company before it can make that loan which may preserve the properties for the benefit of all, and which, if it have a rightful existence at all, must inevitably protect one as much as it does the other? We think it will hardly be contended that it was necessary that Meyer Lewis be a party to this cause

before these certificates, if otherwise valid, could bind him.

(*c*)

WAS MEYER LEWIS IN THE POSITION OF A RAILWAY CREDITOR?

The Circuit Court of Appeals in its opinion, which we will hereafter examine, has made the ground of its sustaining the priority of Meyer Lewis' lien, not only in whole but in part, that, conceding to be true all that we have just been arguing about the power of a court to issue certificates with or without notice, it does not apply to any other person than those who lent their money to a railway company at the outset. These, it is said, and these alone, are bound by those loans which a court may make to preserve railway properties.

To this we have, as is hereafter argued, two replies. One, that Meyer Lewis, after his loan was overdue and could have been entirely called in, suffered the property to be improved by the railway company, and, during several years before its receivership, accepted the interest at its hands. Then, after the appointment of its receiver, he accepted interest at the hands of the court, and suffered the property to remain there almost a year without objection. This man, we think, has brought himself fully within the position of a creditor of a railway company in so far as following the fortunes of its insolvency and operation is concerned. He permitted the railway to build upon the property, apparently without objection, that which was most vital to its operation—its power house. He is now willing to take that property with the improvements entirely away from the railway company just as if he had never had anything to do with it as a railway corporation. His acceptance of interest from the receiver and his permitting the receiver to pay insurance and taxes upon that property when

the road was being operated at a loss by the receiver, we shall advert to in discussing the opinion of the lower court, and there we shall maintain that, without regard to railway doctrines and simply on grounds of general equity, he cannot so behave himself, without some recompense to the court for its protection. At present it is enough to say, that the course of action kept up through several years by Meyer Lewis is not compatible with his stubbornly refusing to have that relation now imposed upon him by a court, when for four years, and, apparently, so long as profitable, he kept it up himself. It seems to us very clear that if Meyer Lewis can snatch this property entirely from the hands of the court the other properties covered by the lien of the certificates will have to bear the whole burden. Those certificates, however, as is alleged, were spread over all the property, including his.

SECOND.

THE MORTGAGE MUST BEAR SOME SHARE OF THE COURT'S EXPENSES.

This is the second branch of our argument, and it depends upon no doctrine of railway insolvency. General equitable doctrines alone need be considered. The certificates merely represent the expenses previously incurred by the court, interest paid to Meyer Lewis in protecting, with the acquiescence of Meyer Lewis, the property on which he had a lien. Even had no certificates been issued, it is evident from the answer that the expenses of the court were exceeding its income and the care of that property which Meyer Lewis had not sought to withdraw from the court had aggravated the deficit. Could, then, the latter avoid his share of the expenses of a court of equity and withdraw his property from its pro-

tection without charge of any kind, when, during nearly a year, he had deliberately elected to have that protection?

The reasoning of the lower appellate court against us may be summed up as follows: Meyer Lewis did not have a hearing before the issue of these certificates. Had he been a railway mortgagee, a hearing, or even notice might not, to be sure, have been necessary, for he would then have been held to accept the fortunes of that class of security. But he was not a railway mortgagee. He lent his money only on city lots and he is not to be put in the position of a railway creditor by his continuing the loan even for years when overdue and after the property had been conveyed to a railway company, or by the railway company's devoting it to railway uses and improving his security with a power-house, or by his accepting interest from the railway receiver while the trust was not yielding operating expenses, or by suffering the court, through that receiver, to pay insurance and taxes on the property, and to sink the estate so much deeper in debt in doing so. The certificates might affect everyone else, but they did not affect him. His lien was not cut off, and it did not have to sustain an equitable accounting in part. He could, in a word, repose with perfect indifference to what the court he knew was doing both for his property and with it. These are the reasonings of the circuit court of appeals.

From the views expressed by Judge Gilbert we respectfully dissent, but, as we have already, we think, replied to them by our general argument, we shall not examine them anew so far as concerns the question whether the mortgage was by the certificates cut off entirely. As to whether it was cut off at least in part, whether it must bear some share of the loan made by the court, we will, however, examine the opin-

ion to point out what we respectfully deem are very clear mistakes of the record.

What we want to charge against the Meyer Lewis' mortgage, says Judge Gilbert, (p. 31) is the insurance and taxes paid upon it by the receiver. No, that is not all, we pray that the interest paid him be also charged (p. 10). Saying nothing about the interest his Honor reasons about the insurance and taxes. These, he continues, have evidently been incurred "on account of improvements placed upon the property by the railway company and not for taxes paid" upon the original lots. Why did his Honor assume this? But he goes on. We have lost nothing by paying him the taxes, since, if we had not paid him these, he could, after paying them himself, have charged the property with them and made us or it pay them back again. Very good, but how about the *insurance* which we paid? This he could not have paid, if we had not, and then have charged us or the property with it again, for there is no stipulation in his mortgage (p. 14) that would give him that right. It will not be contended that the mortgaged estate could be charged with insurance by the mortgagee (1 Jones, Mortgages § 414). If, therefore, the receiver had not paid that insurance, Meyer Lewis would have had to pay it himself *and would have lost it.* Has he not, then, profited by the protection of the court? Has he not increased its burden by his own benefits? But even if the insurance, the interest and the taxes paid by the receiver would all, if paid by Lewis himself, be a charge upon the mortgaged property so that the receiver's paying them was no gift to him, why should it be said that it was no benefit to him at all to have them advanced by us? Surely it was a benefit to him to have other people advance these sums for him even if he might, on paying them himself, make a lien of them. At all

events, it must not be assumed that to do so was no detriment to the receiver. The policy of a court might be entirely different as to advancing these sums, which undeniably protected the lien of Lewis' mortgage, if that lien could disavow them as not benefits received.

This case may well be illustrated by supposing that the receiver had put repairs upon the property or new improvements. The holder of a lien on the original property, fully aware of this, should apply to the court at once and make his objections to it. If he does not, but lets the improvements go on, and the estate gets into embarassment for official expenses, he should pay back what he has received by those improvements in which he has acquiesced. These doctrines do not depend upon the railway principles at all. In considering whether Meyer Lewis' lien should be at least *pro tanto* affected the question is one of equity in general.

Judge Hanford in the circuit and Judge Gilbert in the circuit court of appeals appear to us to have overlooked the obligation of Meyer Lewis to make any objections in the court which he suffered, during nearly a year, to conserve and protect his lien.

The certificates are simply receiver's expenses met in advance by a cash loan. Should the court, in the conservation of a property of any kind not belonging to a railway, say, a city building or a mill, incur official expenses, surely it will not be contended that underlying liens like that of Meyer Lewis here are not bound by them at all. If that can be contended under any circumstances, it will not be contended, we think, where part of those expenses have gone directly into the very property which that underlying lien particularly rests upon and seeks to segregate and withdraw, nay, more,

where the holder of that lien not only has notice of the court's course of action but personally assumes relations with it and makes no objection. It may not be necessary for your Honor to decide whether the holder of an underlying lien is bound by a receiver's expenses when he never even heard of the receivership. This is a stronger case.

For our own part, we think that those whose property or liens passes into the hands of a court through the insolvency of others are in the position of non-residents with property in a foreign jurisdiction. The citizen of London may grumble at the taxes of New York, but his property gets the protection of its laws. He may say he does not want that protection, but still he gets it. Perhaps it will be said that the cases are different. The citizen of London has deliberately invested in New York, so he is not like the owner of property that, without his knowledge and against his will, is dragged into a court, where he is not a party. Suppose, though, the case of personalty wrongfully carried from London to New York. Here the English citizen may follow and reclaim it, may refuse to pay taxes on personalty only temporarily in the state, and may withdraw it. But suppose he knowingly lets it remain in New York. Shall he not then bear taxation? This is Meyer Lewis' case here. The parallel is just and complete. He had his right, on the passing of that property into a receiver's hands, to inform the court by prompt petition that he could not continue the loan, and, when interest was offered him by the court, he should have refused it. As it is, he has played fast and loose. So long as the court could contrive to pay him he liked the relation. When that relation became burdensome, he disavows it altogether. The certificates he ignores, but it is indisputable that his own behavior has made them the more necessary. It is clear that if the court's administration of the

property had made a profit, Meyer Lewis kept himself in a way to enjoy that profit. Why should he not, then, respond to his share of its burdens? The receiver's possession of the property is not denied to have been lawful or, even as against the mortgagee, improper. Why is no part of the expenses a charge against that mortgage?

(*b*)

One thing is not adverted to at all by the lower court. Nowhere does that court say whether the order issuing these certificates as a first lien can be collaterally attacked by Meyer Lewis. Perhaps it will be said that he may so attack it because he was no party to that case at all. But may I collaterally attack, say, the appointment of a receiver because he was appointed when I was no party? His appointment may have been grossly irregular and I no party to the cause, but still, if he sues me, I cannot he heard to dispute that he is the receiver he claims he is.

Why should not Meyer Lewis be now relegated to the court that created the certificates, and, with his acquiescence, sold the property under them? Is it to be presumed that that court has not withheld from the proceeds of the sale sufficient to protect and discharge his lien?

The lower court argues that the purchasers of receiver's certificates buy at their peril. Certainly, no one would deny this. The purchasers at the sale, too, bought at their peril. But every equity that could have been invoked by the holders of the certificates can be invoked by the purchasers at the sale, not to mention the other equities they may invoke on account of Meyer Lewis' silence at that sale.

Again, it is to be observed that Meyer Lewis in his bill narrates the sale but does not seek to set it aside or disturb it. That

sale, however, was presumably for the benefit of all interested parties, so, the question recurs, why does he not go back to the court for his share of the proceeds of the sale, or be forced to show reasons here why that court could not or would not recognize his priority in distribution? It seems to us that he is willing to have that sale cut off everyone except himself. Is he not coming within the case of *Factors' and Traders' Insurance Company* vs. *Murphy* (111 U. S., 738). That was the instance of of an assignee's sale in bankruptcy free of all incumbrances as against an underlying mortgage which sought to ignore it.

"The defendent in error sued in the proper court of the State to foreclose a mortgage given by Paul Cook and Justus Vairin, Jr., to secure the payment of four notes of $10,000 each, given by them in their partnership name of Paul Cook & Co., of which she was then the holder and owner of two, all the notes being of the same date. She alleged that Cook & Vairin had been declared bankrupts, and that by certain proceedings in the bankruptcy court, and under its order, the mortgaged property had been sold free from incumbrance, and bought in by several persons who had liens on it, by whose order it was conveyed to the Factors' and Traders' Insurance Co., which held the other two notes secured by the mortgage. She further alleged that the effect of this sale was to extinguish the mortgage as to the notes held by that company, and all other liens but hers, and to make that company liable to her for the amount of these notes with a first lien on the property mortgaged. That the sale under the order in bankruptcy was not binding on her, because she was not made a party to the proceeding and had no notice of it, while it was binding on all the other lien holders whose liens were thereby discharged, leaving hers a paramount lien on the property."

The court first conceded that the lien of Mrs. Murphy,

the mortgagee foreclosing, was not cut off by the sale, since she was not a party to it. This, says the court, gave her the alternative right of taking her share of the proceeds of the sale and so ratifying it, or, which is what she did, proceeding to foreclose. In pursuing the latter, however, she so proceeded as to "affirm the sale as free of all incumbrances except her own," just as here Meyer Lewis' bill (p. 5) specifically gives us title except as against himself, and at all events does not deny that the sale was valid.

The court then held that sums expended by the purchasers for taxes and necessary repairs would take priority over her mortgage. These purchasers bought like the purchasers under the certificates here, at their peril, but still:

"In this view of the case it is not possble, consistently with any equitable view of the case, to hold that this sale discharged part of the liens against the property and increased thereby the value of the other liens at the expense of the purchasers."

This the court decided because the purchasers bought in the mistaken idea that they bought for her as well as for themselves. But, it will be objected, here none of the sums so expended were expended after the purchase. No, but they were expended for the benefit of Meyer Lewis's lien. Those who advanced money on the certificates, being bound by everything unfavorable in the record, may surely avail themselves of what is favorable. They are accordingly presumed, in taking a first lien on all the properties, to know that this part of those properties had gotten a share of those disbursements that made this loan necessary. The situation in the case first cited is simply the converse of this, not against it. The certificate holders advanced money, as they thought, for the benefit of

everybody in court, just as the purchasers in the *Factors' Insurance* case did for everybody for whom they erroneously believed they had purchased.

Let us in conclusion invoke the settled policy of courts as to good faith towards the holders of such certificates.

"Where such certificates are issued, and the court, as in this case, impresses upon them a preferential lien, good faith requires that its promise be redeemed, unless, perhaps, it be shown that the issue of the certificates was actually fraudulent."

Kneeland vs. *Luce*, 141 U. S. page 508.

The decree should be reversed and the demurrer to our answer overruled.

Respectfully submitted,

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